ARIZONA TAX COURT

TX 2004-000066 09/21/2005

HONORABLE MARK W. ARMSTRONG

CLERK OF THE COURT
C. Danos
Deputy

FILED:_____

PHOENIX SUNS LIMITED PARTNERSHIP
dba DOWNTOWN DIGITAL POST

BRIAN W. LACORTE
JAMES G. BUSBY, JR.

v.

ARIZONA DEPARTMENT OF REVENUE

J. GREG MARBLE

UNDER ADVISEMENT RULING

This matter was taken under advisement after oral argument held August 15, 2005. The Court has considered the Plaintiff's Motion for Summary Judgment and Defendant's Cross Motion for Summary Judgment and arguments of counsel.

I. THE ISSUE

The issue is whether Phoenix Suns Limited Partnership dba Downtown Digital Post ("DDP" or "Phoenix Suns" or "Plaintiff") is entitled to a refund pursuant to the Motion Picture Production Refund Statute A.R.S. § 42-5015 ("MPP Refund Statute"), for 50% of the Arizona transaction privilege and use taxes ("TPT") imposed on tangible personal property that it purchased or leased in Arizona for use in connection with production activity.

II. FACTUAL BACKGROUND

DDP, established in 1992, is a division, or line of business, of the Phoenix Suns Limited Partnership. DDP provides editing services for sports programs and commercial advertising productions, or post-production activities. Plaintiff's clients include sports teams, and advertising agencies.

On April 5, 2001, Plaintiff submitted a request for refund under the MPP Refund Statute for the period of July 1, 1994 through December 31, 2000 ("Refund Period"). A claimant qualifies for a refund under the statute if it meets the following requirements:

- Is a motion picture production company (or "MPCC") that produced one or more motion pictures in Arizona (*see* A.R.S. § 42-5015(A));

- Requests a refund from the Department and agrees to furnish records of qualifying expenses to the Department on request (*see* A.R.S. 42-5015(B));

- Applies for the refund within the allowable time period, submits the appropriate expense reports and pays for its expenses using a checking account maintained at a financial institution in Arizona (*see* A.R.S. 42-5015(C)); and

- Spends more than $1 million or, in the case of commercial advertising production, $250,000, in connection with the production of one or more motion pictures or commercial advertisements in Arizona (*see* A.R.S. 42-5015(D)).

DDP claimed it met all of these requirements. DDP claimed to have produced multiple "motion pictures" as defined under the MPP Refund Statute. DDP further claimed that it and/or its vendors paid $81,465.67 TPT on property that DDP purchased or leased in Arizona for use in its production activities in Arizona during the Refund Period.

Pursuant to the MPP Refund Statute, DDP therefore requested a refund for 50% of the TPT paid on these expenses during the Refund Period, $40,732.83, plus interest. On July 17, 2002, the Arizona Department of Revenue ("Department") denied Plaintiff's refund request as untimely and also as not meeting the requirements of the MPP Refund Statute.

Subsequently, DDP protested the Department's denial of its refund claim. The Hearing Officer at the Office of Administrative Hearings upheld the Department's denial of DDP's refund claim[1] and, upon DDP's appeal to the Department's Director, the Director also upheld the Department's denial of DDP's refund claim. Accordingly, DDP brought this action asking the Court to determine that DDP is entitled to the refund.

III. ARGUMENTS OF THE PARTIES

- Phoenix Suns Limited Partnership dba Downtown Digital Post's Arguments -

A. DDP IS A MOTION PICTURE PRODUCTION COMPANY THAT PRODUCED ONE OR MORE MOTION PICTURES IN ARIZONA.

In interpreting the MPP Refund Statute, the Department defined "motion picture" as "any audiovisual work with a series of related images either on film, tape, or other embodiment, where the images shown in succession impart an impression of motion together with accompanying sound, if any, which is produced, adapted, or altered for exploitation as entertainment,

[1] *See* attachment to the Department's reply memorandum.

advertising, promotional, industrial, or educational media." See A.A.C. R15-5-2240 (the "MPP Refund Rule").

Reading the MPP Refund Statute and the MPP Refund Rule together, a MPCC is "a company engaging in the business of producing [any audiovisual work . . . which is produced, adapted, or altered for exploitation as entertainment, advertising, promotional, industrial, or educational media] for commercial exploitation in movie theatres or through any form of television, videocassettes, videotapes or videodiscs." *See* A.R.S. 42-5015(H)(2) and A.A.C. R15-5-2240(A)(3).

Therefore, DDP is a MPCC because it is engaged in the business of producing audiovisual works that are exploited for entertainment, advertising and promotional purposes through various forms of television and video. Because DDP is a division of a company that also engaged in business as a professional basketball team, the Department argues that DDP is not a MPPC. However, there is no such requirement in the MPP Refund Statute or its implementing rule, and DDP is actively engaged in business as a production company in the Valley.

The Department also argues that DDP is not engaged in production activities because it "does not film or otherwise engage in the production of film." In support of this argument, the Department cited a document prepared by the U.S. Bureau of Labor that categorized various production activities as pre-production, production and post-production activities. The Department implies that DDP does not qualify for the subject refund because it is engaged in post-production activities, as defined by the U.S. Bureau of Labor, rather than production activities as required by the MPP Refund Statute.

However, the Department's own rule, the MPP Refund Rule, defines "production activities" as "those support activities related to the filming of a motion picture but which may occur before or after the actual filming begins or ends in Arizona." *See* A.A.C. R15-5-2240(A)(4). The Department is trying to impose a new requirement that is contrary to its own rule and attempting to impose this requirement retroactively in contravention of A.R.S. 42-5039, which specifically prohibits the Department from retroactively changing its interpretation or application of tax laws and rules.

Additionally, the Department argues that DDP is not a MPCC because it did not personally exploit the motion pictures. The MPP Refund Statute does define a MPPC as: "a company engaging in the business of producing motion pictures for commercial exploitation in movie theatres, or through any form of television, videocassettes, videotapes or videodiscs." Therefore, it is true that the production(s) must be for commercial exploitation in order to satisfy the statutory definition of a MPCC. However, the MPP Refund Statute does not indicate that the MPCC must commercially exploit the productions itself. In this industry it is not uncommon for someone besides the producer to bear the risk and assume the potential reward for attempting to commercially exploit a production. DDP was not required to commercially exploit the productions itself.

B. DDP REQUESTED A REFUND FROM THE DEPARTMENT AND DOCUMENTED ITS EXPENSES.

The Department's administrative rule requires a MPPC to submit the following reports when applying for a refund: a total expenditure report, a payroll expenditure report and a final expenditure report. *See* A.A.C. R15-5-2242. DDP provided the Department with all of the information required by the MPP Refund Statute and the Department's rule.

In addition to the information required by the MPP Refund Statute and the Department's rule, DDP provided the Department with photographs of its production facilities and much of the production equipment that it purchased and copies of all of the invoices for the equipment that it purchased. DDP also took representatives from the Department on a tour of its production facilities. DDP has provided all of the information that the Department requested.

However, the Department argues that to properly document its expenses, DDP "first need[s] to list the productions that it has 'produced' and then establish that a given expenditure was made 'in connection with' a certain production." Thus, over four years after DDP filed its refund claim, the Department attempts to impose documentation requirements that are neither in the MPP Refund Statute nor supported by it. To the contrary, a MPCC simply must expend a threshold amount "in connection with the filming or production of one or more motion pictures or commercial advertisements in this state." There is no authority for the proposition that one must provide a list of all of their productions and then match expenditures to a particular production.

Nevertheless, DDP did identify some of its productions and thoroughly documented its expenses as required by the MPP Refund Statute and the MPP Refund Rule. DDP identified two of the sports programs that it produces and several advertising clients and other companies that it has produced commercials for. DDP uses the same equipment to produce both sports programs and commercials. DDP does not purchase its equipment for any particular production. Rather, it uses the same equipment over and over again on "one or more motion pictures or commercial advertisements," as the MPP Refund Statute permits.

Additionally, the Department argues that DDP failed to demonstrate that it spent the required amount to qualify for the subject refund in multiple twelve-month periods. However, the MPP Refund Statute does not require taxpayers to show that they satisfied the relevant spending threshold in multiple twelve-month periods, only that they spent the required amount "in at least a twelve consecutive month period in connection with the filming or production of one or more motion pictures or commercial advertisements in this state." *See* A.R.S. § 42-5015(D). DDP documented that it spent over $1 million during the Refund Period in connection with the production of numerous commercial advertisements in Arizona. In addition, DDP has shown that it qualifies for the subject refund even if it was required to satisfy the spending threshold in every twelve-month period.

Finally, the Department claims that because some of DDP's equipment was used on productions lasting more than two minutes, DDP must satisfy the $1 million spending threshold rather than the $250,000 spending threshold for producing commercial advertisements. However, the MPP Refund Statute simply provides that:

> The refund provided by this section applies to those motion picture production companies which expend more than one million dollars or, in the case of commercial advertising production, two hundred fifty thousand dollars in this state in at least a twelve consecutive month period in connection with the filming or production of one or more motion pictures or commercial advertisements in this state . . .

See A.R.S. § 42-5015(D).

Thus, DDP only had to demonstrate that it spent more than $250,000 in connection with the production of one or more commercial advertisements in Arizona because it used all of its equipment to produce both numerous commercial advertising productions and numerous sports program productions. The MPP Refund Statute does not provide that a taxpayer must satisfy the higher threshold-spending amount if it used its equipment both on commercial advertisements and on longer productions. It simply provides that MPPCs that produce commercial advertising productions must expend at least $250,000 in connection with the production of such advertisements.

C. DDP APPLIED FOR A REFUND WITHIN THE ALLOWABLE TIME PERIOD, SUBMITTED THE APPROPRIATE EXPENSE REPORTS AND PAID FOR ITS EXPENSES WITH AN ARIZONA CHECKING ACCOUNT.

The MPP Refund Statute provides that one may apply for a refund at any time after expending $250,000 in connection with the production of one or more commercials in Arizona, but must do so within six months after "completing the filming or production activities." *See* A.R.S. § 42-5015(C). In the MPP Refund Rule, the Department indicated that:

> "Completing the filming or production activities" means the later of the date the motion picture production company closes the checking account at the Arizona financial institution or the date the production activities are completed.

See A.A.C. R15-5-2240(A)(4).

DDP satisfied this requirement by applying for a refund in April of 2001. At that time, DDP had spent over $1 million (well over the $250,000 it was required to spend) in connection with the production of numerous commercials in Arizona, had not completed its production activities and had not closed its Arizona checking account.

However, the Department claims that, for in-state MPPCs only, "completing the filming or production activities" does not mean the later of the date the motion picture production company closes the checking account at the Arizona financial institution or the date the production activities are completed. According to the Department, in-state production companies should be required to file a refund request within six months of the completion of "each individual motion picture." Not only is that requirement inconsistent with the plain meaning of the MPP Refund Statute and the MPP Refund Rule it is in violation of Arizona's Administrative Procedures Act and A.R.S. 42-5039.

Because, the Department's interpretation of the statute of limitations is inconsistent with the plain meaning of both the MPP Refund Statute and the MPP Refund Rule, the Department's interpretation is invalid. DDP's refund claim was timely filed pursuant to the plain meaning of the MPP Refund Statute and the MPP Refund Rule. *See Arizona Department of Revenue v. Trico Electric Cooperative, Inc.*, 151 Ariz. 544, 729 P.2d 898, 901 (Ariz. 1986).

Additionally, even if the Department's new interpretation was valid the Department did not take the steps necessary to comply with Arizona's Administrative Procedures Act, A.R.S. § 41-1001 *et seq.*, (by providing notice to the public, opportunities for public comment, etc.). The interpretation does not have the force and effect of law like a duly enacted administrative rule does. The Department is bound by its administrative rules, like the MPP Refund Rule, just as taxpayers are. *See Taylor v. McSwain*, 54 Ariz. 295, 311, 95 P.2d 415, 422 (1939).

Finally, in 1998, the Arizona Legislature specifically prohibited the Department from retroactively changing its interpretation or application of existing administrative rules, like the MPP Refund Rule. *See* A.R.S. 42-5039. The Legislature indicated that any changes to the Department's interpretation or application of administrative rules must be applied prospectively only unless such changes are favorable to the taxpayer. *Id*. Therefore, the Department's new interpretation or application of the MPP Refund Rule cannot affect DDP's refund claim because it can only apply prospectively.

D. DDP SPENT ENOUGH MONEY AND PRODUCED ENOUGH MOTION PICTURES AND COMMERCIAL ADVERTISEMENTS IN ARIZONA TO QUALIFY FOR A REFUND.

DDP meets the fourth and final requirement of the MPP Refund Statute because it spent more than $1 million in connection with the production of one or more motion pictures or commercial advertisements in Arizona. *See* A.R.S. 42-5015(D). As described above, DDP has documented more than enough expenses to demonstrate that it qualifies for the subject refund whether the expenses are cumulative, as the statute indicates, or have to be broken out for each twelve-month period based on either a fiscal or calendar year-end basis.

A. THE LEGISLATIVE INTENT OF THE MPP REFUND STATUTE WAS TO PROVIDE AN INCENTIVE FOR MOVIE COMPANIES TO COME TO ARIZONA AND MAKE MOVIES.

The Arizona Supreme Court declared that the Court's "primary goal when interpreting a statute is to discern and give effect to legislative intent." *People's Choice TV Corp., Inc. v. City of Tucson*, 202 Ariz. 401, 403, 46 P.3d 412, 414 (Ariz. 2002). The Arizona Court of Appeals held that the courts are to "give the language its full meaning," and that to do so it must "construe the statute as a whole, and consider its context, language, subject matter, historical background, effects and consequences, and its spirit and purpose." *State ex rel. Arizona Dep't of Revenue v. Phoenix Lodge No. 708, Loyal Order of Moose, Inc.*, 187 Ariz. 242, 247, 928 P.2d 666, 671 (Ariz. App. 1996), *cited with approval in People's Choice TV*, 202 Ariz. at 403, 46 P.3d at 414.

The intent of the MPP Refund Statute is very clear. The Legislature intended for this statute to provide incentives to out-of-state movie companies to come to Arizona and make movies, thereby luring the profits of the movie-making industry to Arizona rather than another state. Plaintiff, a resident sports franchise was not intended to benefit from this exemption. It is well settled that credits, exemptions, and refunds are strictly construed against the taxpayer and in favor of the taxing authority. *See Davis v. Arizona Dept. of Revenue*, 197 Ariz. 527, 529-30, 4 P.3d 1070, 1072-73 (Ariz. App. Div. 1 2000).

B. PLAINTIFF IS NOT A MOTION PICTURE PRODUCTION COMPANY.

Plaintiff is not entitled to a refund under the MPP Refund Statute because it is not an MPPC as defined in this statute. To qualify for the credit, a taxpayer must first establish that it meets the precise definition of an MPPC under A.R.S. § 42-5015(H)(2). Under this statute, an MPPC is defined as follows:

> 'Motion picture production company' means a company engaging in the business of producing motion pictures for commercial exploitation in movie theaters, or through any form of television, videocassettes, videotapes or videodiscs.

Therefore to be considered an MPPC, a taxpayer must prove two essential elements: (1) that it is engaged in "the business of producing motion pictures," and (2) that it commercially exploits these productions.

1. Plaintiff Is Not In The Business Of Producing Motion Pictures.

Plaintiff is not a movie company that is in the business of producing movies. Rather, Plaintiff is a professional sports franchise that also peripherally performs some editing for it and others. The Plaintiff's tax I.D. and TPT number is issued to the Phoenix Suns Limited

Partnership. The Arizona Corporation Commission does not list DDP as a separate entity.

Plaintiff claims that because a part of its business involves editing services, it is an MPPC. To support this contention Plaintiff cites its listing in "The Business Journal" as one of the Valley's "top twelve film and production companies." However, The Business Journal is not the authority on interpreting statutory language. Its listings do not determine whether a company qualifies as a MPPC as defined by the Arizona State Legislature under the MPP Refund Statute. Plaintiff also asserts that it is "engaged in the business of editing commercials, sports programs and other productions, or 'motion pictures.'" However, that alone is not sufficient to qualify as an MPPC within the meaning of A.R.S. § 42-5015(H)(2).

The Department concedes that Plaintiff provides editing services. On its web site, DDP lists that its services include "apply[ing] the finishing touches that enable us to finesse your elements into a polished, final product." However, it does not film or otherwise engage in the production of film. Rather, a third party produces the film and then delivers the produced film to Plaintiff for editing. In the film industry, "pre-production" is the process of establishing goals and objectives for a film, including the necessary planning involved in the selection of the appropriate location, equipment, personnel, etc. "Production" is the creation of the raw film through the filming process under the guidance of a director, or the actual making of the film. "Post-production" is the process of compiling the raw footage into a final product.[2] DDP, at best, is only engaged in post-production activities.

To further support its claim that it is a MPPC, Plaintiff points to the repealed definition of "production activities" to allege that the Department's own rule implies that editing is tantamount to producing motion pictures. The repealed rule on which Plaintiff relies defined "production activities" as activities that "may occur before or after the actual filming begins or ends." A.A.C. R15-5-2240(A)(4). However, where a certain activity is made up of multiple elements, just because one of those elements is a part of the overall activity does not mean that the single element, by itself, is the equivalent of the overall activity.

2. Plaintiff Does Not Commercially Exploit The Productions.

Even if Plaintiff was deemed to be in the business of producing motion pictures, it is not an MPPC because it does not "commercially exploit" its productions. As stated above, A.R.S. § 42-5015(H)(2) specifically requires that to qualify as a MPPC, a company must not only prove that it engages in the business of producing, but it must perform these activities for the purpose of "commercial exploitation" of the motion picture.

"Commercial exploitation" is not defined in the statute or the rules. However, based on its plain meaning, the Plaintiff does not "commercially exploit" or "sell" its sports programs to

[2] See information produced by the U.S. Department of Labor, Bureau of Labor Statistics, Career Guide to Industries, Motion Picture and Video Industries, found at: http://www.bls.gov/oco/cg/cgs038.htm.

the open market, nor does it "sell" or control the advertising commercials, which it edits, to networks for commercial exploitation. It is either the advertising agencies or the advertisers themselves that exploit the commercials edited by the Plaintiff by choosing when, how, or even if, the commercials will be placed with various television stations. Plaintiff simply performs an editing service for itself or others who may or may not commercially exploit the edited product. Plaintiff does not itself commercially exploit the productions.

Therefore, Plaintiff is not a MPCC as it is defined in A.R.S. § 42-5015(H)(2). Plaintiff is not engaged in the business of producing motion pictures and even if considered so Plaintiff fails to commercially its "productions" as required.

C. PLAINTIFF FAILS TO ESTABLISH THAT IT MET THE THRESHOLD SPENDING REQUIREMENT.

Even if this Court determines that Plaintiff is an MPPC, it still does not qualify for a refund under the MPP Refund Statute because it has not established that it meets the threshold expenditures requirements. In order to qualify for the credit under the MPP Refund Statute, a taxpayer must meet the applicable expenditure requirements of either $1,000,000 or $250,000, depending on the nature of the production, within a twelve-month period. Plaintiff does not satisfy the required threshold expenditure requirement under A.R.S. § 42-5015(D).

A.R.S. § 42-5015(D) specifically states:

> The refund provided by this section applies to those motion picture production companies which expend more than one million dollars or, in the case of commercial advertising production, two hundred fifty thousand dollars in this state in at least a twelve consecutive month period in connection with the filming or production of one or more motion pictures or commercial advertisements in this state.

1. No Proof That Expenditures Were Made "In Connection With" Any Productions.

Plaintiff claims that it spent "well over $1 million in tangible personal property that [it] purchased or leased in Arizona for use in connection with its production activities." However Plaintiff offers no proof, other than a self-serving statement given by its general manager, that any of the expenses it has reported are "in connection with" any of the productions it edited. In fact, Plaintiff has never offered a specific list of any of its productions at all.

Further, the assets and expenses that Plaintiff does list do not offer clear descriptions or stated use. The invoices submitted by Plaintiff show that Plaintiff even included office furniture, decoration, and design within its final expenditure report. Plaintiff has not explained how any

of the items listed in its final expenditure report were used for any productions qualifying under the MPP Refund Statute or that they were used for any motion picture production at all.

2. Expenditures Do Not Meet The Threshold Within A 12-Month Period.

Next, even if Plaintiff could establish that the expenditures were made in connection with some production activity, Plaintiff has failed to demonstrate that it expended either threshold amount as required under A.R.S. § 42-5015(D). Plaintiff has not only failed to establish that it meets one of the thresholds, it has failed to even establish which threshold applies in its case.

In order to use the smaller expenditure threshold, Plaintiff must establish that all of its expenditures were used for the purpose of producing commercial advertising. *See id.* "Commercial advertising production" is defined in A.R.S. § 42-5015(H)(1) as "any film or video production that is created to promote specific brands, products, services, retailers or advocacy positions and that consists of two minutes of air time or less." A.R.S. § 42-5015(H)(2). Therefore, any expenditures that apply to productions that last more than two minutes cannot be considered "commercial advertising production" and thus such expenditures must meet the higher threshold.

Plaintiff claims that "[b]ecause DDP used all of its equipment to produce both numerous commercial advertising productions and numerous sports program productions, it only had to demonstrate that it spent more than $250,000 in connection with the production of one or more commercial advertisements in Arizona." Plaintiff has confused the threshold spending requirement under A.R.S. § 42-5015(D). Just because Plaintiff alleges that it produced both commercial advertising production and non-commercial advertising production, does not mean that it only has to satisfy the smaller threshold amount. Assuming the expenditures were made for proper purposes, in order to determine which threshold applies, Plaintiff must allocate the expenditures to particular productions. If any expenditures were made in connection with its sports programs, which consist of more than "two minutes of air time," then the expenditures do not qualify as being in connection with "commercial advertising production" and therefore Plaintiff would have to meet the higher $1 million threshold of expenditures per year for such production(s) in order to qualify.

Plaintiff states that it "spends approximately 65% of its time producing commercials and approximately 35% of its time producing sports programs." However, Plaintiff cannot attribute any of its expenditures to any specific commercial productions. Plaintiff has failed to meet its burden of proving that it spent more than the $250,000 (in any of the twelve month periods of the Refund Period) "in connection with the filming or production of one or more . . . commercial advertisements." A.R.S. § 42-5015(D).

Plaintiff has also failed to meet the higher expenditure threshold. A.R.S. § 42-5015(D) requires that if the productions are anything but "commercial advertising production," then a taxpayer must prove that it expended "more than one million dollars . . . in this state" within a

twelve-month period "in connection with the filming or production of one or more motion pictures."

In its Refund Claim, Plaintiff reported to have had total production expenditures as follows:

1995	1996	1997	1998	1999	2000
$290, 827	$370,969	$1,403,985	$985,572	$780,436	$677,348

Plaintiff explains that these figures were determined by adding asset purchases in the given year to a number derived from its profit-loss statement for that year. The profit-loss statements are made on a fiscal year basis, year ending June 30. The calendar year expenditures (shown above) are calculated by allocating one-half of fiscal year expenditures to each half of the calendar year. Even if this method of determining the amount of expenditures were accepted, 1997 was the only year that Plaintiff spent one million dollars. However, with this calculation method between fiscal and calendar years, it is unknown if the one million dollars was actually even spent in 1997 rather than in 1996 or 1998 instead.

Again, even if Plaintiff established when the money was spent, Plaintiff has failed to establish that its expenditures listed in its final expenditure report were made "in connection with" any specific qualifying productions. Based on the numbers reported, Plaintiff failed to meet the one million dollar threshold for most, if not all, of the years in its Refund Period. Further, because it has failed to establish that any of its expenditures were made "in connection with" any specific qualifying productions, it fails to establish that it met either threshold in any of the years in its Refund Period.

Plaintiff claims that because it spent over $1 million in connection with its editing activities during the entire Refund Period, it qualifies for the refund. Plaintiff argues that the MPP Refund Statute "does not require taxpayers to show that they satisfied the relevant spending threshold in multiple twelve-month periods, only that they spent the required amount 'in at least a twelve consecutive month period . . .". This interpretation is wrong.

Contrary to Plaintiffs argument, the absence of express language in the MPP Refund Statute to declare that the threshold requirement applies to each consecutive tax year further confirms that the Legislature did not intend for this Refund to apply to resident MPPCs that had continuous activity in this state. As originally drafted, the threshold requirement stated:

> The refund provided by this section shall be applicable only to those motion picture production companies which expend greater than one million dollars in this state in connection with the filming or production of one or more motion pictures in this state within a twelve month period.

Laws 1992, Ch. 96. HB 2258, 40th Leg., 2nd Reg. Sess., 1992. The Legislature did not need to clarify that it applied year after year on multiple productions done by an MPPC because the statute was only meant to apply to a company that came into Arizona from out of state for the sole purpose of shooting its movie. The statute was not intended for a taxpayer that would be staying year after year as a resident company would. Plaintiff's interpretation of the requirement is erroneous and leads to an unintended result, especially when combined with Plaintiff's argument that resident taxpayers effectively have no statute of limitations. If all a taxpayer had to do was spend $1 million during only one consecutive 12 month period of the entire Refund Period, then a taxpayer could spend the required $1 million and then benefit from a 50% reduction in its TPT as long as it stayed in business or didn't close its Arizona checking account.

Plaintiff also argues that as long as any portion of its editing applied to commercial productions, then it only has to meet the smaller threshold of $250,000. However, where the statute provides two different thresholds that apply to two different types of production, it is necessary to determine which threshold applies to a taxpayer's activities.

Plaintiff claims to have produced both commercial advertising productions and non-commercial advertising productions. If Plaintiff qualifies for the MPP Refund, it will receive a refund of 50% of the TPT which it paid for expenses "in connection with its" non-commercial activities. *See* A.R.S. § 42-5015(A). Therefore, in order for Plaintiff to receive a refund for TPT it paid in connection with the non-commercial production activities, it must meet the $1 million threshold of expenditures for non-commercial productions. The statutes provide two distinct thresholds for two distinct types of productions. Plaintiff's interpretation ignores the statute's express distinctions. Statutes should not be read to render their language meaningless. *See Devenir Associates v. City of Phoenix*, 169 Ariz. 500, 503, 821 P.2d 161, 164 (Ariz. 1991).

Because Plaintiff has failed to substantiate which expenditures apply to its commercial activities and which expenditures apply to its non-commercial activities, it, it has not met either of the two threshold expenditure requirements under A.R.S. § 42-5015(D).

D. PLAINTIFF'S REQUEST FOR REFUND WAS UNTIMELY.

Finally, Plaintiff is not entitled to a refund under the MPP Refund Statute because its request for refund was not timely filed. The statute provides a statute of limitations for filing the refund claim. Originally, the refund claim had to be filed "within sixty days after completing the filming or production activities in this state." A.R.S. § 42-1322.01(A)(1992). With the 1995 amendment, the statute of limitations was extended to "six months after completing the production." A.R.S. § 42-5015(C). This statute of limitation for filing the refund claim in its entirety reads as follows:

> The motion picture production company shall apply for the refund with the department within six months after completing the filming or production activities but may apply at any time after the motion picture production company reaches

> one million dollars in expenditures or, in the case of commercial advertising production, two hundred fifty thousand dollars in connection with filming or producing one or more motion pictures or commercials in this state, but not to exceed the twelve month period as prescribed in subsection D.

This provision establishes the time for the filing of a refund application that begins when a taxpayer reaches the minimum spending requirement for a twelve-month period and that ends six months after the taxpayer completes the film or production.

Plaintiff relies upon the language of A.A.C. R15-5-2240(A)(2), which defined the term "completing the filming or production activities," to assert that its Refund Claim was timely filed. As explained below, this rule was repealed in January of 2004. While the Department does not dispute that the Rule was in effect during the Refund Period, it does disagree with the Plaintiff as to the correct interpretation or applicability of the rule in this case. Prior to its repeal, A.A.C. R15-5-2240(A)(2) stated:

> 'Completing the filming or production activities' means the later of the date the motion picture production company closes the checking account at the Arizona financial institution or the date production activities are completed in the state.

Plaintiff claims it satisfied the statute of limitations because it "had not completed its production activities and had not closed its Arizona checking account." However, the repealed rule should be considered in its context.

This rule was adopted after the original enactment of the MPPC statute, before any statutory amendment and prior to any awareness of the issues of in-state production companies. The legislative minutes and history of the originally enacted statute demonstrate that the vision of the Legislature was that a movie company would come into Arizona, shoot their movie, finish up, and then pack up and leave Arizona. As such, the original statute, as well as the MPP Refund Rule, was drafted to accommodate such a situation. The rule was never subsequently amended to define when production is "completed" for a resident company, if indeed a resident company would be allowed to qualify at all for this refund, and as such this rule did not take into account that a production company might come into Arizona and stay and continue to produce.

A.A.C. R15-5-2240(A)(2) provided two possible dates for the beginning of the "six month" period of A.R.S. § 42-5015(C): Either the date when an MPPC completes the production activities in the state, or the date when it closes its Arizona account. In light of the context under which R15-5-2240(A)(2) was drafted the closing of the Arizona account phrase makes sense for non-resident MPPCs. However, if applied to Arizona companies, it would render the statute of limitations meaningless. A resident MPPC would not need to open a bank account in Arizona to handle expenses of the production and then close it after it pays out its final expenses for the production, as would a non-resident MPPC. The bank account of a resident MPPC would continue as long as the company was solvent. Thus, a resident MPPC's statute of limitations

would be unlimited. This would violate the intent of the statute.

Next, the second option for triggering the "six month" statute of limitations period in R15-5-2240(A)(2) is similar to the statutory language under A.R.S. § 42-1505(C), which states that the six months begins to toll upon the completion of the "production activities." A.A.C. R15-5-2204(A)(4) defined the term "production activities" as "those support activities related to the filming of a motion picture." *Id*. This definition refers to the production of a single motion picture. The completion of "production activities" as referenced in A.R.S. § 42-5015(C) and A.A.C. R15-5-2240(A)(2) therefore likewise refers to the completion of each individual motion picture.

Plaintiff argues that the term "production activities" refers to an MPPC's continuing production business rather than each individual production. Again, this interpretation would render the statute of limitations meaningless. Under this interpretation, a resident MPPC will never reach such a date short of going out of business. This is not the intention of the rule or statute. Subjecting non-resident MPPCs to a six-month statute of limitations while permitting resident MPPCs to never be confronted with a statute of limitations would discriminate against the very class of benefactors which the legislature intended to entice: the out-of-state MPPC companies. This result is contrary to legislative intent.

Accordingly, in the case of a resident MPPC that continues to produce multiple and separate productions in Arizona, the "completion" of filming or production must be as to each production or commercial, and the refund requests must be filed within six months after each production. In this case, Plaintiff filed its request for refund on April 5, 2001. Therefore, Plaintiff's request for refund would only be timely for those expenditures that the company has had while it was engaged in productions completed after November 5, 2000. Plaintiff has not given a list of any completion dates for any of its productions, nor specific expenditures that apply to such productions.

Plaintiff argues that the term "production activities" in A.A.C. R 15-5-2240(A)(2) refers to a company's continuing production business, and not to each individual production. When applied to resident MPPCs, Plaintiff's interpretation would render the Rule meaningless. As previously stated, under Plaintiff's interpretation a completion of production activities within the meaning of this Rule would occur only when a company stops its production altogether or when it ceases to exist. This is not the intention of the rule. Just as the general statute of limitations is relevant for each tax period and for each transaction within such tax period, the specific limitation provision of A.R.S. § 42-5015(C) applies to each motion picture production for which a refund is requested.

This is consistent with the threshold spending requirements in A.R.S. § 42-5015(D), which allow the inclusion of "one or more motion pictures" in the calculation of the relevant amount. The reference to "one or more motion pictures" in those minimum-spending requirements does not define the statute of limitation provision in A.R.S. § 42-5015(C). The

reference in the threshold spending requirements simply means that a taxpayer does not have to fulfill those requirements with just a single motion picture production. Instead, a taxpayer can add up its expenditures for all motion pictures or all of its commercial productions produced within a twelve-month period for the purpose of reaching the relevant threshold-spending requirement. This is a different requirement and a different period than the statute of limitations provision. Fulfilling one requirement – the threshold-spending requirement – does not exempt a taxpayer from fulfilling the other – the statute of limitations provision.

Plaintiff argues that the application of the limitation provision in cases where a taxpayer reaches the threshold expenditure requirement only after the limitation period has run, would be impractical because it ignores the longer period allowed for meeting the threshold expenditure requirement. This argument is flawed. The twelve-month period in the threshold expenditure requirement does not mean that all the expenditures made during those twelve months must necessarily also qualify for the refund. It simply means that for purposes of the minimum expenditure requirements, a taxpayer may look back twelve months, even though it may only base its requested refund amount on productions completed within the past six months. Plaintiff's attempt to connect the two different periods is inconsistent with the very precise requirements in the statutes.

The Department's interpretation is the only logical interpretation. That is, the six month limitations period that begins upon "completing the 'production activities'" as set forth in A.R.S. § 42-5015(C) runs separately for each production. This is consistent with principles of equity and fairness and is consistent with the definition of "production activities" which is defined as "those support activities related to the filming of a motion picture." A.A.C. R15-5-2204(A)(4).

Applied to this case, the refund claim would only be timely for expenditures that are shown to be connected with a production completed after November 5, 2000. Because Plaintiff has failed to establish the completion date for any of the productions that it edited, none of the expenditures in its Refund Claim were timely filed.

E. THE DEPARTMENT'S INTERPRETATION DOES NOT VIOLATE ARIZONA'S ADMINISTRATIVE PROCEDURES ACT NOR DOES IS VIOLATE A.R.S. § 42-5039.

Plaintiff alleges that the Department is retroactively attempting to impose new requirements into the statute, and that such actions violate A.R.S. § 42-5039. The Department, however, has not imposed – nor is it attempting to impose – new requirements in any part of the statute. The requirements set forth by the Department are derived from the plain meaning of the language and intent of the statute.

IV. THE COURT'S FINDINGS AND CONCLUSIONS

As advocated by the Department and recently restated by the Supreme Court in *Arizona Department of Revenue v. Capitol Castings, Inc.*, 207 Ariz. 445, 447, 88 P.3d 159 (2004) the standard for the Court when interpreting tax statutes is to strive to "discern and give effect to legislative intent." *People's Choice TV Corp. v. City of Tucson*, 202 Ariz. 401, 403, P7, 46 P.3d 412, 414 (2002). The Court also must "construe the statute as a whole, and consider its context, language, subject matter, historical background, effects and consequences, [as well as] its spirit and purpose." Id. (quoting *State ex rel. Ariz. Dep't of Revenue v. Phoenix Lodge No. 708, Loyal Order of Moose, Inc.*, 187 Ariz. 242, 247, 928 P.2d 666, 671 (App. 1996)).

In tax cases, the Court liberally construes statutes imposing taxes in favor of taxpayers and against the government, *Ariz. Tax Comm'n v. Dairy & Consumers Co-op Ass'n*, 70 Ariz. 7, 18, 215 P.2d 235, 242-43 (1950), but strictly construes tax credits, exemptions, and refunds because they violate the policy that all taxpayers should share the common burden of taxation. *See Tucson Transit Auth., Inc. v. Nelson*, 107 Ariz. 246, 252, 485 P.2d 816, 822 (1971); *Davis v. Arizona Dept. of Revenue*, 197 Ariz. 527, 529-30, 4 P.3d 1070, 1072-73 (Ariz. App. Div. 1 2000); *71 Am. Jur. 2d State and Local Taxation* §§ 232, 233 (2001). Nevertheless, an exemption should "not be so strictly construed as to defeat or destroy the [legislative] intent and purpose." *W.E. Shipley, Annotation, Items or Materials Exempt from Use Tax as Used in Manufacturing, Processing, or the Like*, 30 A.L.R.2d 1439, 1442 {88 P.3d 162} (1953).

The Department argues that the Legislature intended for the MPP Refund Statute to provide incentives to out-of-state movie companies to come to Arizona and make movies, thereby luring the profits of the movie-making industry to Arizona rather than another state. Therefore, Plaintiff, a resident company, was not intended to benefit from this exemption. However, the Court considers the Department's interpretation too narrow. Based on the Court's review of MPP Refund Statute, considering the plain and ordinary meaning of the words used in the statute along with the legislative background, the Court cannot agree that resident state movie companies were to be excluded.

Having reached that conclusion the Court next looks at whether resident Plaintiff satisfies the requirements of A.R.S. §42-5015 – the MPP Refund Statute:

- Is a motion picture production company that produced one or more motion pictures in Arizona (*see* A.R.S. § 42-5015(A));

- Requests a refund from the Department and agrees to furnish records of qualifying expenses to the Department on request (*see* A.R.S. 42-5015(B));

- Applies for the refund within the allowable time period, submits the appropriate expense reports and pays for its expenses using a checking account maintained at a financial institution in Arizona (*see* A.R.S. 42-5015(C)); and

- Spends more than $1 million or, in the case of commercial advertising production, $250,000, in connection with the production of one or more motion pictures or commercial advertisements in Arizona (*see* A.R.S. 42-5015(D)).

The Court concurs with Plaintiff's argument that it is a MPCC that produced one or more motion pictures in Arizona. The Department argues that DDP is not engaged in production activities because it "does not film or otherwise engage in the production of film." But the Department's own rule, the MPP Refund Rule, defines "production activities" as "those support activities related to the filming of a motion picture but which may occur before or after the actual filming begins or ends in Arizona." *See* A.A.C. R15-5-2240(A)(4). Clearly, Plaintiff's activities are included in this definition. The Department further argues that Plaintiff fails to meet the "commercial exploitation" requirement of the MPP Refund Statute relating to productions. Again, the Court agrees with Plaintiff's argument on this issue. Finally, the Department argues that DDP is not a MPPC because DDP is a division of a company that also engaged in business as a professional basketball team rather than a separate legal entity only engaged in business as a MPPC. The Court again concurs with Plaintiff that there is no such requirement in the MPP Refund Statute or its implementing rules.

Having decided that Plaintiff is a MPCC for purposes of applying the MPP Refund Statute, the Court moves to the remaining requirements of the statute. The Court finds that Plaintiff would be entitled to a refund only for expenses incurred "in connection with filming or production of one or more motion pictures or commercial advertisements in this state." A.R.S. § 42-5015(D).

Further, the Court agrees with the Department's position that the window for filing a refund claim under A.R.S. § 42-5015(C) opens when a company meets its threshold spending requirement and closes six months after "completing the filming or production activities." On the other hand, the Court agrees with Plaintiff that if it proves it spent at least $250,000 in the relevant time period on commercials, it may use that threshold even though it spent additional sums on productions other than commercials. However, the Court finds that Plaintiff has not apportioned its spending with sufficient specificity to take advantage of the $250,000 threshold.

Finally, the Court finds that A.R.S. § 42-1106 imposes an overall four-year limitation period that is applicable to Plaintiff's claim, regardless of any other limitation period that may apply. This is particularly the case here where, according to Plaintiff's argument, there would otherwise be no limitation period for resident producers with continuing operations, which could not have been the Legislature's intent. Otherwise, the Court finds that genuine issues of material fact preclude summary judgment on all remaining statutory requirements.

IT IS THEREFORE ORDERED granting in part and denying in part Plaintiff's Motion for Summary Judgment to the extent set forth above.

IT IS FURTHER ORDERED granting in part and denying in part the Department's

Cross-Motion for Summary Judgment to the extent set forth above.

Unfortunately, the statute and rules applicable to this case were not drawn as tightly as they might have been. Both sides have posited both reasonable and tortured interpretations in support of their arguments. The Court would encourage the parties to explore settlement of this claim in light of the above legal conclusions. If the parties are unable to settle, either party may request the court to set a pretrial scheduling conference, or a trial date if a pretrial scheduling conference has previously been held.